Flour Mills of Nig. Plc

Nigeria | Equities | Consumer Goods | August 22, 2022 PAC RESEARCH

Good Start to Financial Year as Three Business Segments Maintain Double Digit Growth

INVESTMENT SUMMARY

In the first quarter of 2022/23, Flour Mills of Nigeria (FMN) maintained stellar performance as revenue accelerated by 45.31% to ₦339.60 billion (vs. ₦233.70 billion in the first quarter of 2021/22). The improvement recorded in the top-line is mainly attributed to the strong volume growth in key business segments of the company during the period. However, the cost of sales increased significantly by 47.28% to ₦306.35 billion in Q1'22/23 (vs. ₦208.00 billion in Q1'21/22), mainly as a result of improved production volumes and higher input costs (driven mainly by rising inflation) during the period. In addition, rising inflation and higher energy costs bit hard on the selling, distribution and administrative expenses during the period. Selling and distribution expenses increased by 50.52% to ₦4.61 billion in Q1'22/23 (vs. ₦3.06 billion reported in Q1'21/22). Also, the administrative expenses rose by 52.70% to ₦10.07 billion in Q1'22/23 (vs. ₦6.60 billion reported in Q1'21/22). Despite the higher operating expenses, the operating profit of the company improved by 32.74% to ₦15.29 billion in Q1'22/23 (vs. ₦11.52 billion in Q1'21/22).

The net finance costs of the company rose by 87.07% to ₦7.96 billion in Q1'22/23 (vs. ₦4.25 billion reported in Q1'21/22) as FMN raised its financial leverage by increasing both the short-term and long-term loans during the period. Despite the setback in non-operating activities, profit before tax grew slightly by 0.92% to ₦7.33 billion in Q1'22/23 (vs. ₦7.26 billion in Q1'21/22). During the period, the company made a provision of ₦1.83 billion for tax (vs. ₦1.82 billion in Q1'21/22). Notwithstanding the higher tax provision, profit after tax improved marginally by 0.91% to ₦5.45 billion (vs. ₦5.50 billion in Q1'21/22), resulted in a 12-month trailing Earnings Per Share (EPS) of ₦6.84 during the period. With impressive operating performance, we maintain a **BUY** rating as present forward estimates places the company share price at ₦35.20 (Previous TP: ₦36.77).

Table 1: Quarterly results highlights

	1Q2023	4Q2022	1Q2022	Q/q Δ	Y/y Δ
Revenue (₦'mn)	339,601	338,822	233,703	+0.23%	+45.31%
Operating profit (₦'mn)	15,285	25,070	11,515	-39.03%	+32.74%
Net profit (₦'mn)	5,496	10,970	5,446	-49.90%	+0.92%

Source: Bloomberg, PAC Research

Oluwole Adeyeye
oluwole.adeyeye@panafricancapitalholdings.com

Price:	
- Current	**₦29.05**
- Target	**₦35.20**
Recommendation:	**BUY**

** As at Friday August 19, 2022*

Table 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	+2.47%/+0.17%
52-week range	₦41.45 - ₦27.50
30-day Average vol.	2,466,218
Shares Outstanding ('mn)	4,100.38
Market Cap. (₦bn)	119.12
EPS, ₦- 12months trailing	6.84
DPS, ₦- FY2022	2.15

Source: NGX, Company's Annual Reports, PAC Research

Tab 3: Key ratios

	Q1'23	Q1'22
Gross profit margin	9.79%	11.00%
COS/Revenue	90.21%	89.00%
Net Profit Margin	1.62%	2.33%
Asset turnover	0.39	0.43

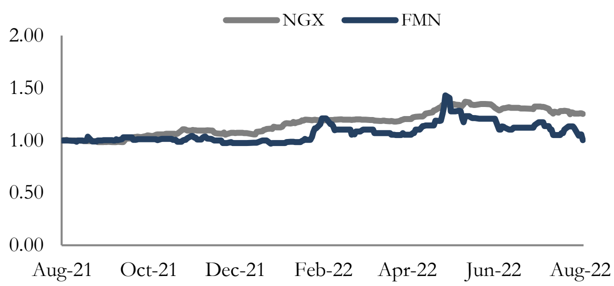
Source: NGX, PAC Research

Table 4: Valuations

	FY2021	FY2022	FY2023E	FY2024F
P/E(x)	4.63	4.25	3.90	3.54
P/B(x)	0.68	0.61	0.58	0.52
Div. Yield	5.68%	7.40%	8.26%	9.29%
Payout Ratio	26.31%	31.47%	32.19%	32.93%
Ev/Revenue	2.68	2.70	3.02	3.00
Rev Per Shr.	188.18	283.83	354.79	390.26
ROE	14.73%	14.30%	14.76%	14.69%
ROA	4.72%	4.20%	3.42%	3.47%

Source: NGX, PAC Research

Fig. 1: FMN vs NGX, 52-wk Movement (Rebased)



Source: Bloomberg, PAC Research

Revenue rises by 45% year-on-year, driven by higher production volume: Flour mills of Nigeria continued with impressive performance in the first quarter of 2022/23 as revenue increased by 45.31% to ₦339.60 billion (vs ₦233.70 billion reported in the first quarter of 2021/22), driven by strong volumes and revenue growth across all the key business segments of the company. The revenue of Food Segment improved by 45.08% to ₦213.17 billion in Q1'22/23 (vs. ₦146.93 billion in Q1'21/22), driven by growth in Business-to-Consumer (B2C) and Business-to-Business (B2B) core revenue categories – Flour, Ball foods, Noodles and Pasta. In line with our projection, the acquisition of majority stake in Honeywell Flour Mills Plc (HFMP) contributed about 5% (₦11.4 billion) to the revenue of food segment during the period. In addition, the revenue of Agro-Allied Segment increased significantly by 37.67% to ₦65.65 billion in Q1'22/23 (vs. ₦47.69 billion Q1'21/22), driven by the strong revenue growth in Oil & Fats (96%), Fertilizer (21%) Starch (36%) and Animal Feed (21%) businesses. The company attributed the growth in Oil & Fats business to increased toll milling activities and contracts in the North and increased revenue from export business. Meanwhile the growth in Fertilizer business was largely due to launch of new SKU (Stock-Keeping Unit) and improved customer interface engagements. The company attributed the growth in Animal Feed business to investments in logistics infrastructure and farmer training extension services across the country.

In line with our projection, the acquisition of majority stake in Honeywell Flour Mills Plc (HFMP) contributed about 5% (₦11.4 billion) to the revenue of food segment during the period.

Also, the Sugar segment posted a revenue of ₦55.02 billion in Q1'22/23, which is 64.11% higher than the ₦33.53 billion reported in Q1'21/22. The increase in the revenue of the Sugar segment was largely driven by the strong volume growth in Golden sugar (white Sugar). In addition, the Brown sugar products gained traction, following sustained demand from the North and other industrial customers.

Meanwhile Support Segment is the only segment with a single digit growth as it rose by 3.58% to ₦5.76 billion in Q1'22/23 (vs. ₦5.56 billion Q1'21/22), driven by strong revenue growth from Golden Transport Company and packaging business.

Going forward, we maintain that extension of blending plants and sales outlets, expansion of fertilizers business into northern and eastern markets and the acquisition of majority stake in Honeywell Flour Mills will continue to contribute positively to revenue of FMN.

Fig. 2: Revenue – 3M'21 – 12M'24F (Billion NGN)

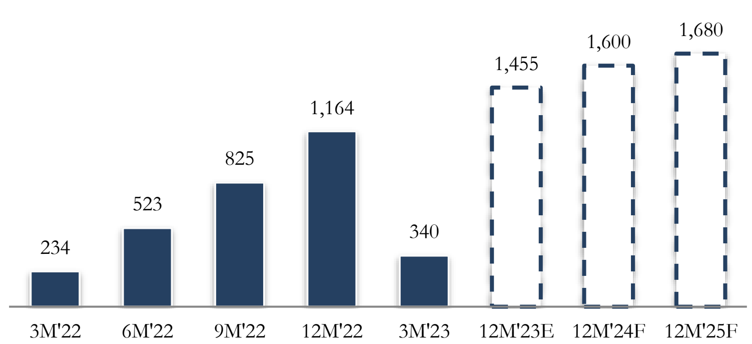
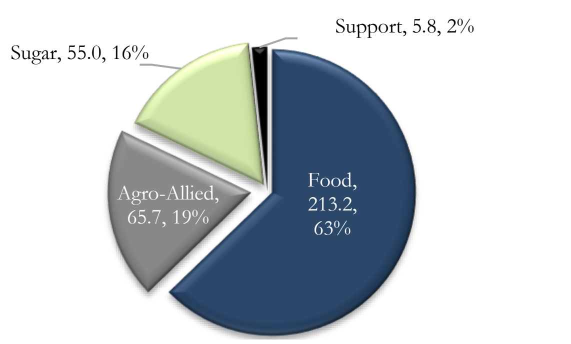


Fig. 3: Contribution to Revenue by Segment (Billion NGN) – 3M'22/23



Source: NGX, PAC Research

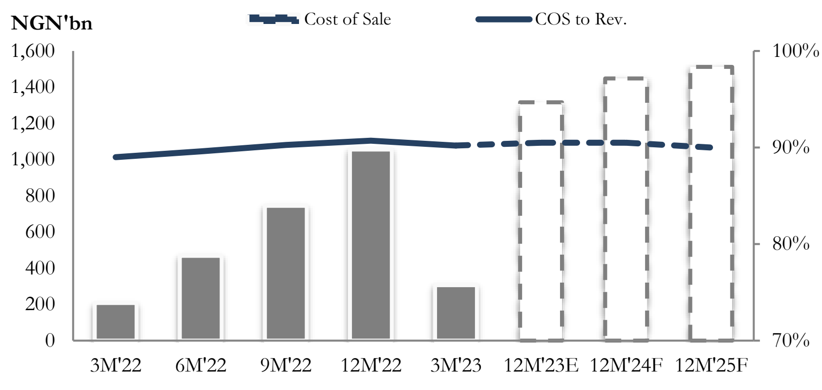
With the expectation of improved production volume and rising inflation rate, we may likely see further increase in the cost of sales, selling, distribution, and administrative expenses in the coming quarters.

Cost of sales rises by 47.28% year-on-year, driven by higher production volumes and inflationary pressure: In the first quarter of 2022/23, the cost of sales accelerated by 47.28% to ₦306.35 billion (vs. ₦208.00 billion in the first quarter of 2021/22), driven by higher production volumes and inflationary pressure, which reflected in the input costs during the period. Specifically, the cost of raw and packing materials, which constitutes about 90% to the total cost of sales, increased by 48.78% to ₦276.77 billion in Q1'22/23 (Q1'21/22: ₦186.03 billion). Although, the improved production volume and inflationary pressure are the key contributors to the overall increase in the cost of sales, the cost-to-sales margin, which rose slightly to 90.21% in Q1'22/23 (from 89.00% in Q1'21/22), remains a major factor to watch.

In addition, the administrative, selling and distribution expenses of the company rose significantly by 52.01% to ₦14.68 billion in Q1'22/23 (vs. ₦9.66 billion reported in Q1'21/22), driven mainly by inflationary pressure which resulted in higher selling expenses, increased advertisement expenses, higher general administrative expenses, higher salaries, wages and other staff costs, among others.

With the expectation of improved production volume and rising inflation rate, we may likely see further increase in the cost of sales, selling, distribution, and administrative expenses in the coming quarters.

Fig. 4: Cost of Sale and COS to Revenue – 3M'22 – 12M'25F



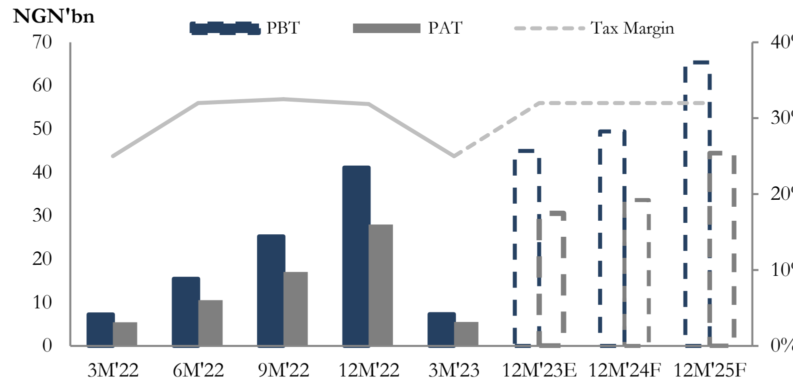
Source: NGX, PAC Research

Despite the setback in non-operating activities, profit before tax grows slightly by 0.92% year-on-year: The net finance costs of the company increased significantly by 87.07% to ₦7.96 billion in the first quarter of 2022/23 (vs. ₦4.25 billion in the first quarter of 2021/22). The significant increase in net finance costs might have been driven by the acquisition of majority stake in Honeywell Flour Mills, improved financial leverage and high interest rate during the period.

Meanwhile, the impressive operating performance outweighed the setback in non-operating activities during the period. Hence, profit before tax improved slightly by 0.92% to ₦7.33 billion in Q1'22/23 (vs. ₦7.26 billion in Q1'21/22).

The company made a provision of ₦1.83 billion for tax in Q1’22/23 (vs. ₦1.82 billion recorded in Q1’21/22). Consequently, profit after tax improved slightly by 0.91% to ₦5.50 billion in Q1’22/23 (vs. ₦5.45 billion reported in Q1’21/22), translating to a 12-month trailing EPS of ₦6.84 during the period.

Fig. 5: PBT, PAT and Tax Margin – 3M’22 - 12M’25F



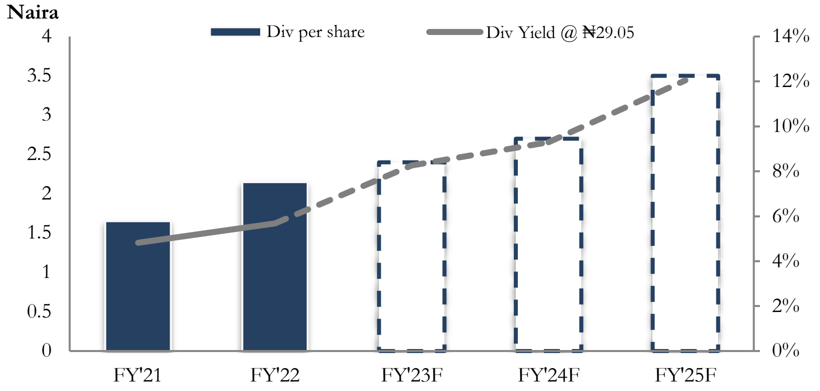
Source: NGX, PAC Research

Balance sheet remains strong: Expectation of historical dividend payment in FY’22/23: Flour Mills of Nigeria maintained a strong financial position in the first quarter of 2022/23 as the total assets of the company improved by 69.92% to ₦880.46 billion (vs. ₦540.41 billion in the first quarter of 2021/22), driven mainly by additional investment of ₦122.69 billion in property, plant & equipment, 97% increase in inventories, 32% improvement in prepayments & deposit for import, among others. However, the total liabilities of the company rose significantly by 88.32% to ₦678.61 billion in Q1’22/23 (vs. ₦360.35 billion in Q1’21/22), due to notable increase in total borrowings, trade and other payables, among others. The total borrowing increased by 110.57% to ₦294.69 billion in Q1’22/23 (vs. ₦139.95 billion in Q1’21/22), driven by notable increase in borrowing from Bank of Industry (₦23.89 billion), Real Sector Support Facility (₦87.95 billion) and other banks loans (₦115.70 billion). The improvement in the total assets of the company outweighed the setback in recorded total liabilities during the period. Consequently, the net assets increased by 12.10% to ₦201.85 billon in Q1’22/23 (vs. ₦180.06 billion in Q1’21/22) which translated to a net assets per share of ₦49.23 (Q1’21/22: ₦43.91).

The total borrowing increased by 110.57% to ₦294.69 billion in Q1’22/23 (vs. ₦139.95 billion in Q1’21/22), driven by notable increase in borrowing from Bank of Industry (₦23.89 billion)...

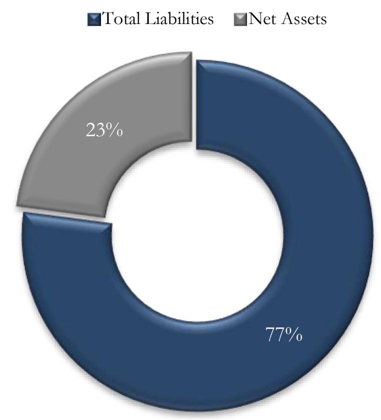
With the recent improved overall operating performance, robust balance sheet, expectation of improved performance in the operating activities of the company in the coming quarters, resultant synergy from acquisition of majority stake in Honeywell Flour and positive outlook from the management, we expect the Flour Mills of Nigeria to maintain its historical dividend payment in the full year of 2022/2023.

Fig. 6: Dividend Per Share and Dividend Yield – FY'21-FY'25F



Source: NGX, PAC Research

Fig. 7: Total Liabilities Vs Net Asset in Q1'22/23



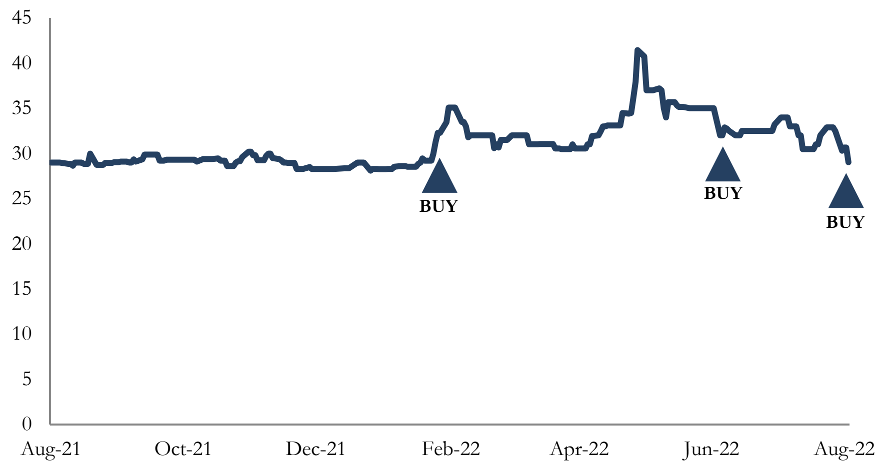
Source: NGX, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦30.25, representing an increase of 21.18% from the current market price of ₦29.05. In arriving at the target price, we employed dividend discount methodology. Consequently, we maintain a **BUY** recommendation on the stock of the company. Our valuation and forecasts considered several factors (both quantitative and qualitative) – The previous financial reports of the company, the current figures released by the company, the synergies from acquisition of HFMP, the expansion to different regions within the country and the outlook from the management.

Our valuation puts the target price of the stock at ₦30.25, representing an increase of 21.18% from the current market price of ₦29.05.

Fig. 8: Share Price History (Naira)



Source: NGX, PAC Research

Table 5: Statement of Profit or Loss, N'mn

	2021	2022	2023E	2024F
Revenue	771,608	1,163,803	1,454,754	1,600,229
Change		*50.83%*	*25.00%*	*10.00%*
Cost of sales	-664,851	-1,055,713	-1,316,552	-1,448,207
Change		*58.79%*	*24.71%*	*10.00%*
Gross profit	106,757	108,090	138,202	152,022
Change		*1.25%*	*27.86%*	*10.00%*
Selling and distr exp.	-12,080	-11,080	-14,548	-23,203
Change		*-8.27%*	*31.29%*	*59.50%*
Administrative exp.	-29,046	-31,776	-43,643	-41,606
Change		*9.40%*	*37.34%*	*-4.67%*
Net Op. gains (losses)	-15,528	-136	-1,455	-1,600
Change		*-99.12%*	*970.58%*	*10.00%*
Operating profit	52,197	65,513	77,684	84,652
Change		*25.51%*	*18.58%*	*8.97%*
investment income	3,652	1,086	2,182	3,200
Change		*-70.25%*	*100.86%*	*46.67%*
Profit Before Tax	37,194	41,118	44,952	49,447
Change		*10.55%*	*9.32%*	*10.00%*
Taxation	-11,477	-13,103	-14,385	-15,823
Change		*14.17%*	*9.78%*	*10.00%*
Profit After Tax	25,717	28,015	30,567	33,624
Change		*8.94%*	*9.11%*	*10.00%*

Table 6: Statement of Financial Position, N'mn

	2021	2022	2023E	2024F
Property plant and equip.	208,721	226,840	334,593	352,050
Investment property	1,533	1,427	1,746	1,920
Goodwill	4,148	4,148	4,364	4,801
Deferred tax	6,974	6,245	7,274	8,001
Long term receivables	39	38	15	16
Inventories	195,449	284,463	370,962	408,058
Biological assets	376	757	727	800
Trade and other rec.	25,826	39,901	49,462	54,408
Total Assets	544,733	667,012	894,863	968,347
Bank overdraft	4,001	9,938	29,095	14,402
Trade & other payables	120,152	194,592	218,213	240,034
Borrowings	26,913	34,017	130,928	144,021
Retirement benefit oblig.	10,397	10,269	11,638	12,802
Long service award	3,713	3,591	5,964	6,561
deferred tax	16,857	15,023	20,367	22,403
Total liabilities	370,119	471,107	687,807	739,466
Net Assets	174,614	195,905	207,055	228,881

Table 7: Profitability Ratio

	2021	2022	2023E	2024F
Gross profit margin	13.84%	9.29%	9.50%	9.50%
Net Profit Margin	3.33%	2.41%	2.10%	2.10%
operating profit margin	6.76%	5.63%	0.00%	0.00%
Return on Equity	14.73%	14.30%	14.76%	14.69%
Return on Assets	4.72%	4.20%	3.42%	3.47%
ROCE	1.09%	0.29%	0.49%	0.65%

Table 8: Asset Utilisation

	2021	2022	2023E	2024F
cash/sales	0.06	0.05	0.05	0.05
Sales to inventory (x)	3.95	4.09	3.92	3.92
Sales to total assets (x)	1.42	1.74	1.63	1.65
sales/EBITDA	9.83	13.28	11.84	12.11
Sales to total fixed assets	3.70	5.13	4.35	4.55
Equity multiplier	3.12	3.40	4.32	4.23

Table 9: Liquidity Ratios

	2021	2022	2023E	2024F
Quick ratio	*0.53*	*0.43*	*0.35*	*0.36*
Current ratio	*1.46*	*1.40*	*1.18*	*1.22*
Cash ratio	*0.22*	*0.19*	*0.15*	*0.16*
Interest Coverage	*1.99*	*1.61*	*1.29*	*1.29*
Operating Cash Flow Ratio	*0.00*	*0.00*	*0.00*	*0.00*
Debt/net income	*4.11*	*4.45*	*6.19*	*5.66*
Debt/operating profit	*28.96*	*114.83*	*86.67*	*59.50*
Debt to asset	*0.19*	*0.19*	*0.21*	*0.20*
Debt to equity	*0.61*	*0.64*	*0.91*	*0.83*
Total liabilities/equity	*2.12*	*2.40*	*3.32*	*3.23*
Inventory turnover days	*107.30*	*98.35*	*102.85*	*102.85*
Account receivable days	*12.22*	*12.51*	*12.41*	*0.18*
Account payable days	*65.96*	*67.28*	*60.50*	*60.50*

Table 10: Shareholders' Investment Ratios

	2021	2022	2023E	2024F
Earnings per share	6.27	6.83	7.45	8.20
DiV per share	1.65	2.15	2.40	2.70
NAVPS	42.58	47.78	50.50	55.82
Earnings yield	21.59%	23.52%	25.66%	28.23%
P/S ratio	0.154	0.102	0.082	0.074

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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PanAfrican Capital Holdings Ltd
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalholdings.com